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Real Economy

Monthly review of Moldovan economy and policy

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Real Economy is a monthly economic review, tracking the most important economic evolutions and policy developments in Moldova. Its readers are policymakers, CEOs of domestic and international companies and banks, representatives of the international institutions and foreign embassies, political parties and economic journalists.

Acronyms and abbreviations: y-o-y - year on year; q-o-q - quarter on quarter; m-o-m – month on month; e-o-p – end of period; Q4:07 – fourth quarter 2007; Jan:09 – January 2009; NBS – National Bureau of Statistics; NEA – National Employment Agency; NBM – National Bank of Moldova; MDL – Moldovan leu (national currency); p.p. - percentage points.

EXPERT-GRUP is a Moldovan independent think-tank whose mission is to create a working environment in which free and non-trivial thinking thrives in order for the institution to be a leading source of unbiased economic analysis and to effectively advocate for innovative ideas and solutions to the economic problems that Moldova encounters along its path of economic transformation, societal development and European integration.

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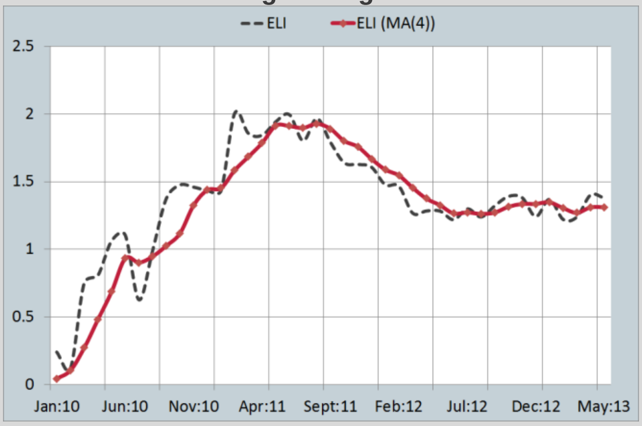
Evolution of the Economic Leading Indicator

The Economic Leading Indicator (ELI) updated for May:13 shows a fledgling revival, mainly supported by a healthy expansion in lending, remittances and consumption. Thus, it confirms the first signs of economic recovery taking place at the beginning of this year, with a 3.5% annual GDP growth in Q1:13.

Chart 1. Economic Leading Indicator, raw data and 4-Months Moving Average



Source: EXPERT-GRUP calculations based on NBM, NBS and Logos-Press;
Note: Values of exports for May:13 have been estimated by authors.

In May:13 total new loans increased by 19.2% y-o-y, right after an abundant 24.8% y-o-y growth in Apr:13. The main contribution belongs to the expansion of corporate lending in national currency, which catapulted by 60.5%, whereas the corporate loans in foreign currency shrank by 33.9%, y-o-y. For the period Jan-May:13, total remittances registered a robust 10.6% y-o-y growth, with the increasing share of transfers from Russia and decreasing share of those from EU. Thus, the share of money transfers denominated in Russian rubles grew from 25.9% in Jan:13 to 30.5% in May:13. In May:13, the money in circulation grew by 24.5% y-o-y, which is both impressive and dangerous, at the same time. The reason is that on the one hand it denotes a recovery in consumption, while on the other hand it poses long-term inflationary pressures. Hence, a major challenge faced by the central bank is to preserve price stability amid the persistence of abundant liquidities within the economy. Importantly, this risk should also be addressed by other line institutions (e.g. Ministry of Economy), which, through joint efforts, should enhance the business climate in order to channel this money into investment activities.

On the downside, the banks' loan portfolios remain plagued by a relatively high share of non-performing loans (12.9% in May:13, up from 12.6% in Apr:13) and the exports remain volatile, with a 8.7% y-o-y drop in exports to CIS in Apr:13. Moreover, the unsolved financial issues at Banca de Economii and legal disputes among stakeholders at Moldova Agroindbank challenge the banking sector stability.

All in all, the Economic Leading Indicator remains volatile, revealing high uncertainty regarding the domestic macroeconomic prospects. Moreover, the recent climate anomalies are likely to take their toll on the agricultural sector recovery expected for this year. Coupled with difficult economic conditions in Russia and EU, it could have direct repercussion on the economic growth for this year. Therefore, any upward revisions for the GDP growth forecasts, which are usually tempting for public officials, should be treated with maximum caution.

Key economic figures and data

Agriculture. During the first five months of 2013, the government spent on budget allocations on agriculture only 47.5% of the planned level, which is one of the lowest execution rate among other sectors. Most of these funds were used for recurrent subsidies for private farm inputs, while spending far less on rural infrastructure and technology development. Yet international evidence suggests that returns to private input subsidies are typically several times lower than returns to investments in public goods, such as agricultural research and extension, rural roads and irrigation. During Q1:13, the total value of agricultural production decreased by 3.5%, while the exports increased by 23% and imports – 10.5% y-o-y. During January – April 2013 exports of food and live animals were ranked second, representing 18.1% of total value of exports; imports of food and live animals showed a 11.0% share in total imports.

Industry. In Jan-Apr:13 the Industrial Production Index showed a 106.4% y-o-y growth, while only in Apr:13 this index soared by 123.5% y-o-y. Out of all industries the highest growth for Jan-Apr:13 was registered by the 'Manufacture of grain mill products' from 119.2% in January to 214.4% in April, followed by the 'Manufacture of other non-metallic mineral products' from 160.9% to 205.8%, the 'Distilled alcoholic beverages' from 121.8% to 193.6%, also the 'Manufacture of electrical machinery and apparatus' from 108.3% to 181.6% and the 'Manufacture of tobacco products' from 63.2% to 168%.

Services. In Q1:13, services accounted for 65.1% of GDP, higher by 2.8 p.p. compared to Q1:12, being is in line with the traditional structure of the national economy. It also denotes the weak tradable sectors (agriculture and industry), which undermines the country's export potential. The gross value added in the service sector has increased by 2.8 p.p. y-o-y, thus pushing the GDP up by 1.9 p.p. In Q1:13, constructions recorded the largest increase in workload (+10.5%), followed by wholesale and retail trade (+3.5%), other services (2.3%) and transport and communications (+1.8%). The turnover of goods in May:13 increased by 2.3% m-o-m and by 3.8% y-o-y. The same month turned to be worse for enterprises of railway, truck, river and air transport, where the turnover sloped by 0.6% m-o-m and by 0.8% y-o-y. During Jan-May:13 by rail was transported 1.6745 million tons of cargo (+22.4% y-o-y). From the "other services" of GDP in Q1:13, significant increases occurred for other activities of collective, social, personal and private household services (+12.2%), real estate, renting and business activities of enterprises (+6.6%), hotels and restaurants (+3.0%). Slight increases in the volume of activity were registered in health care and social assistance (+0.9%) and financial activities (+0.7%). On the downside, the GVA shrank in education (-2.9%) and public administration (-1.8%), in y-o-y terms.

Households' income and expenditure. In Apr:13, the gross nominal average earning grew by 11.6% to 3739.7 lei, while the real wage increased by 6.8%, y-o-y. The total personal disposable income (DPI) for Q1:13 constituted 1559.8 lei per household per month, which represents the average amount of money available for spending and saving after deducting income taxes. Salaries continue to be the largest source of income, forming 42.5% of total revenue available. Household income in urban areas was on average 787.1 lei or 1.7 times higher than rural income. The main source of income in urban areas is the employment, representing 53.6% (56.8% in Q1:12) and social benefits - 17.0% (14.7% in Q1:12). In rural areas, the main source of income is the employment as well (28.9%), but its contribution is almost twice less than in urban areas, the revenues from individual agricultural activities provided 19.3% of total disposable income. Money transfers from abroad remains an important source of household budget. On average, in Q1:13 they represent 16.6% of total revenues, and their contribution is 1.1 percentage points higher than in Q1:12. The rural population relied much stronger on remittances compared to the urban one, with a share of 21.0% in the revenue of rural households and only 13% in urban areas. Given the higher living standards, urban population consumes much more compared to the rural one: in Q1:13 the average consumption expenditures in urban areas were 1993.2 lei per person per month, i.e. 589 lei higher or 1.4 times more than in rural areas.

Public finance. In Jan-May:13, state budget revenues posted a healthy 8.2% y-o-y growth, boding well for further fiscal consolidation. Excises' collections increased by 24.4%, while VAT receipts – by 17.6%, which confirms the consumption driven recovery taking place in the current year. Despite this positive dynamics, the total budget revenues continued to underperform with respect to the planned level, with an execution rate of only 98.3% of the plan. The main reason is related to the disbursements of foreign grants, which during the first five months of 2013 amounted only 42.2% of the planned level. It becomes even more worrisome, if we will take into consideration the strong reliance of the state budget on this financing source: in 2012 foreign grants constituted the third main source of revenue to the state budget, after VAT and excises.

Labor market. In Q1:13 the number of economically active population (employed and unemployed) increased by 1.6% y-o-y. The share of employed in active population fell from 92.8% to 91.9%, while the share of unemployed rose from 7.2% to 8.1%. Due to higher ageing rate, the share of economically active population in rural areas was lower than in urban areas: 48.3% and 51.7% respectively. The employed population increased by 0.6% y-o-y, being driven by the non-agricultural activities and mostly by constructions and services, where the number of people employed grew by 7.4% and, respectively, 10.5% y-o-y. On the downside, the number of people employed in industry fell by 9.5%. All in all, the employment in non-agricultural activities grew by 1.1% y-o-y. The situation in the agricultural sector is gloomier, with a 1.4% decline in the number of people employed during the same period of time. The average workweek constituted 42.5 hours in the non-farm sector. On average, men worked 8 hours 5 minutes per day, which is by 37 minutes more than for women. The longest duration of the working day was registered for employees (8.8 hours), and the lowest - in unpaid family workers (5.1 hours). The share of employed men is higher compared to the share of employed women by 6.7 p.p. (i.e., 40.3% and 33.6%).

Prices. In May:13, the annual headline inflation (CPI), posted a 5.7% growth, visibly accelerating from 4.5% in the previous month. There are three key factors which explained this rather sharp upward shift in consumer prices. Firstly, the National Bureau of Statistics changed the methodology of CPI computation, by including the prices of new fruits and vegetables sold for the first time this year and which are much more expensive. Therefore, the y-o-y growth in foodstuffs' prices, being the main component of CPI, increased from 6.1% in Apr:13 to 10.0% in May:13. Secondly, the recovery, though mild, in household consumption fueled to a certain extend the demand-side inflationary pressures. As a result, the annual core inflation (CPI which excludes the foodstuffs, beverages, fuels and products and services with regulated prices) increased from 3.9% in Apr:13 to 4.2% in May:13. Thirdly, the gradual depreciation of the national currency gave an additional fillip to price increase.

Monetary policy. The central bank preserves an accommodative monetary policy in order to set the stage for a healthy economic take off and prevent the economy sinking into deflation. Therefore, the NBM's policy rate was kept at its historical low of 3.5%, which in real terms is almost zero, taking into account that the annual CPI is expected to hover at a similar level by the end of 2014. While maintaining its base rate constant, the central bank continued to sterilize the excessive liquidities from the banking system: in May:13, the total volume of sold NBM certificates increased by 14.4%, y-o-y.

Financial indicators. In May:13, the banks granted by 19.2% more loans compared to May:12, with the main contribution from corporate lending in national currency, which grew by 60.5%. However, the corporate loans in foreign currency shrank by 33.9%, y-o-y, revealing the banks' shift against foreign exchange rate risks. Total new deposits in national currency plummeted by 24.1% and those in foreign currency – by 32.2%. Nevertheless, it was mainly driven by the financial difficulties at Banca de Economii, where the stock of total deposits shrank by 14.2%. At the same time, most commercial banks expanded their deposits' portfolio. Credit expansion slightly improved the bank's returns on equity, from 10.4% in Apr:13 to 10.5% in May:13. Moreover, despite the decline in new deposits, the overall system remains well capitalized (the capital adequacy ratio was 23.6%, with the minimum allowed threshold of 16%) and abundant in liquidities (current liquidity indicator was 32.2%, with the minimum allowed threshold of 20%). Consequently, neither of banks did resort to the NBM's credit facility. On the downside, the banking system remains plagued by high rate of toxic assets: the share of non-performing loans constituted 12.9%, up from 12.6% in Apr:13.

***Foreign trade*.** During Jan-Apr:13, total exports posted a healthy 12.7% y-o-y growth, decelerating from 15.4% in Jan-Mar:13 and 18.2% in Jan-Feb:13. It has been caused primarily by the growth slowdown of exports to EU countries, due to the economic difficulties in this region. Exports to CIS remained robust, increasing by 13.8%, y-o-y for Jan-Apr:13. Still, the most remarkable evolution registered the exports to Turkey, which were by 3.6 times higher compared to the same period of the previous year. As a result, Turkey became the third most important destination for Moldovan exports, outpacing Italy. Total imports, compared to exports, grew at a slower, but accelerating pace (+6.0% in Jan-Apr:13, up from 3.7% in Jan-Feb:13) owing to consumption-driven economic recovery.

Key trading partners. In Q1:13, Russia's GDP growth slumped to 1.6%, from 4.8% a year earlier, while the Ministry of Economics lowered its forecast for the country's 2013 GDP growth from 3.7% to 2.4%. Moreover, many independent analysts are even more pessimistic, arguing for a recession for the second half of 2013. These prospects are not very encouraging for the Moldovan economy, as it is likely to weaken the exports to Russia, as well as remittances and FDI from this country, which traditionally play an important role in Moldova. The EU remained mired in depression with the GDP down by 0.7% in Q1:13, y-o-y, the harshest slump being registered in the Euro area (-1.1%). Italy, Spain and Portugal, which are among the most important economic partners of Moldova due to trading ties and remittances inflows, posted -0.5%, 0.5% and respectively 0.4 y-o-y growth. Still, the most important trading partner from EU, Romania, registered a 0.7% economic growth, which supported the Moldovan exports to this destination.

***Global and regional markets*.** The global economy appears to be transitioning toward a period of more stable, but slower growth. Global gross domestic product (GDP), which slowed in mid-2012 is recovering, and according to the latest World Bank forecast a modest acceleration in quarterly GDP is expected during 2013. Overall, growth in high-income countries is estimated to recover gradually, with GDP increasing by a modest 1.2 percent this year, but setting to 2.0 and 2.3 percent in 2014 and 2015, correspondingly[1]. As for the situation of the regional markets, many countries have still not recovered from the crisis. Unemployment and output gap remain high, as the banking-sector, households' consumption and fiscal restructuring have weighed down activity. Nonetheless, growth has strengthened in Lithuania, Turkey, and Ukraine. A positive development is that funding costs in core Euro Area countries have declined, and lending has started to rebound. Imports, exports, and industrial production have all returned to positive although modest growth.

[1] 'Global Economic Prospects', June 2013, World Bank

Key policy developments in June 2013

Policy development	EXPERT-GRUP commentary
June 6 The chief of EU Delegation to Chisinau, Dirk Shuebel, stated at the third International Forum held in Tiraspol, that EU is willing to support the businesses from Transnistria in order to cope with the requirements of the forthcoming DCFTA between Moldova and EU.	The reluctance of Transnistrian authorities to comply with the DCFTA requirements, coupled with low competitiveness of the regional economy and poor harmonization with the EU standards is the main challenge related to implementing the DCFTA over the entire territory of Moldova. The main risk stem from the fact that in case DCFTA provisions will be applied only on the right-bank of Nistru, Transnistria will automatically be treated by EU as a third party, which will results in replacement of the current Autonomous Trade Preferences system by more restrictive MFN tariffs. It will make the exports of Transnistrian firms to EU much more expensive and, hence, less competitive. For an economy where EU forms about 40% of total exports, it will imply a strong negative shock, resulting in a GDP drop by about 3%-4%, according to various calculations.
June 12 Ministry of Agriculture and Food Industry / MAIA / released on June 12, 2013 the first round of public discussions on the draft 'Strategy for development of agriculture and rural development in the Republic of Moldova for the years 2014-2020'. Discussions took place in Costesti, Ialoveni with the participation of the ministry officials, local farmers and civil servants in the central region of the country. Similar public discussions are held in the North and South regions. Agriculture Ministry officials hope the Government will approve the project this summer and the Parliament will adopt it in the autumn session.	The importance of having in place such a strategic document that should be endorsed and discussed with all relevant stakeholders is incontestable. This is true not only for securing potential international funding, but also to have a clear vision of 'where' the agricultural sector and rural development should head. A similarly important step would be the development of a concrete detailed action plan with clearly defined activities and delimited responsibilities for the implementation of the named strategy. The draft Strategy for development of agriculture and rural areas foresees the increase of competitiveness, sustainable management of natural resources and improvement of living standards in villages.
June 12 Negotiations on Free Trade Agreement of Moldova and the EU officially ended on Wednesday June 12. Both sides have started procedures for the initiation of the agreement. It is estimated the agreement to be implemented next year and it will affect the entire territory of Moldova. In negotiations were discussed not only tariff issues, but also those related to food security and energy security.	Signing the agreement will have not only direct effects (fostering the national welfare and exports) on Moldova, but also indirect ones, such as improving the economic and foreign investments in the long run. The DCFTA Agreement is part of the Association Agreement and this, in turn, is the closest form of cooperation with the EU to third countries. It should provide economic integration of Moldova into the EU and involves the gradual liberalization of trade in goods and services, free movement of labor, reduction of customs duties and non-technical barriers. It is necessary to stress though, that in the short run the Agreement will have certain risks especially for the agricultural sector, as certain businesses might succumb to the increased competition. Moreover, with only one third of national standards being harmonized with EU ones, unsolved Transnistrian issue, poor competitiveness of Moldovan producers and multiple structural deficiencies, Moldova will have to employ a lot of effort in order to reap the benefits of DCFTA. Hence, signing this Agreement should not be regarded by the Moldovan authorities as a terminal station, but rather an additional impulse for further reforms aimed at modernization of the Moldovan economy.
June 25 Between 19 and 24 June, the International Monetary Fund delegation visited Chisinau. IMF mission advanced some recommendations to the government, among others: to abandon the single tax in agriculture and agricultural VAT reduction. Chisinau is therefore	These recommendations come at the end of an IMF mission to Chisinau after stalling for several months in Moldova's relations with the Fund and early termination of the financing program because of several outstanding commitments on the background of political instability.

Policy development	EXPERT-GRUP commentary
recommended to refrain from replacing other agricultural taxes with a consolidated one, so as not give rise to a number of economic, social and fiscal problems.	The consolidate tax in agriculture was decided right before the demission of the Government and the most criticized decisions by the IMF already entered in force and were adopted by the Parliament and formally published. It is necessary to stress though that with regards to the single tax in agriculture, most of the farmers and local authorities disagreed with the named initiative, as this is a law that favors the big farmers in the expense of the small ones, while the small farmers constitute the great majority. Considering this, the named law was not yet approved.
June 26 The negotiations on an association agreement with the EU were concluded. Moldova Cooperation Council **-** The European Union confirmed the negotiations on the Association Agreement, including the Free Trade Agreement with the EU. Council counts on initialing Eastern Partnership meeting in Vilnius on November 29, and the signing will be completed as soon as the technical procedures will be finalized.	The European Union welcomed the progress made by Moldova in terms of the second and final phase of the Action Plan on visa liberalization and free travel, which reconfirms the goal of free travel of Moldovan citizens in the EU in the shortest terms.
June 27 The Ministry of Economy, after consultations with IMF representatives in Moldova, revised upwards the official GDP growth forecast from 3.5% to 4.0% for 2013, on the grounds of relatively robust economic growth registered during Q1:13.	The main reason for this revision is related to the compensatory growth in agriculture, growth in exports and recovery in households' consumption. Moreover, we can assume a certain self-fulfilling effect, as the public officials' optimism can have spillover effects through the entire economy, boosting the consumers' and business' confidence. Nevertheless, Ministry of Economy should have consulted not only the IMF officials, but the central bank as well, for the sake of forecast revision accuracy. Moreover, the regional economic woes remain relevant, with decelerating growth in Russia and depression in EU.

Statistical annex

Table 1. Key Monthly Indicators

Indicator	Jun:12	Jul:12	Aug:12	Sep:12	Oct:12	Nov:12	Dec:12	Jan:13	Feb:13	Mar:13	Apr:13	May:13
Industrial production, y-o-y, % ch.	0.2	1.0	-5.2	-10.7	-6.0	-7.9	-3.1	-2.1	-0.7	1.5	6.4	n.a.
Retail trade, y-o-y, % ch.	0.2	1.6	1.9	-1.2	4.3	-2.6	-12.4	-3.5	6.7	-1.9	0.6	n.a.
Services to the population, y-o-y, % ch.	2.0	2.6	3.7	2.5	-1.8	3.5	-1.2	9.3	7.4	4.1	13.1	n.a.
Exports of goods, y-o-y, % change	3.7	-9.9	-15.8	2.4	-0.4	-11.0	-14.1	9.9	25.9	11.1	5.2	n.a.
Import of goods, y-o-y, % change	-3.7	0.4	-3.3	-7.1	6.2	-3.4	-5.7	2.8	4.5	2.5	13.9	n.a.
Official reserve assets, million USD	2059.0	2094.3	2231.6	2326.8	2421.5	2422.4	2515.0	2519.7	2488.1	2469.1	2481.0	2475.3
Freighted cargo, y-o-y, % ch.	23.9	23.1	-11.5	-16.2	13.9	1.4	-16.4	-13.5	41.3	31.0	25.2	0.8
Registered unemployed at NEA (e-o-p)	31722	29412	27243	25552	24609	25586	26297	26643	27160	26324	24723	22107
Real salary, y-o-y, % ch.	6.1	5.4	5.7	3.2	6.0	5.3	4.9	8.8	4.1	7.0	6.8	n.a.
Budgetary revenues, y-o-y, % ch. *	12.3	16.1	14.5	12.7	13.3	14.1	11.2	9.5	14.9	14.3	12.7	8.7
CPI, y-o-y, %	3.7	4.0	4.4	4.9	3.9	3.7	4.1	4.6	4.4	4.2	4.5	5.7
IPPI, y-o-y, %	6.0	5.0	4.8	5.3	5.0	4.1	4.5	1.6	2.8	3.4	3.7	3.0
Nominal exchange rate MDL/USD (e-o-p)	12.26	12.54	12.47	12.39	12.27	12.37	12.06	12.10	12.25	12.41	12.31	12.52
Money transfers from abroad, y-o-y, % ch.	-7.4	4.5	3.7	-5.8	23.6	3.6	-0.9	22.6	9.7	4.9	23.1	0.6
M2 monetary aggregate, y-o-y, % ch	11.8	14.1	18.2	21.4	20.8	23.7	23.5	27.2	26.1	23.4	25.0	26.7
NBM base interest rate, %	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	3.5	3.5
Banks deposits interest rate, % (e-o-p)	7.59	7.40	7.15	7.94	7.72	7.96	8.44	8.55	8.56	8.09	7.33	7.75
Banks credits interest rate, %	13.69	13.38	12.82	12.58	13.0	12.68	11.98	12.41	13.23	12.77	12.4	12.21
Non-performing loans, % of total loans	15.3	15.2	15.3	14.5	14.4	14.7	14.5	14.6	14.5	13.0	12.6	12.9

Source: NBS, NBM, calculations and estimates EXPERT-GRUP;

Table 2. Key Quarterly Indicators

Indicator	Q1:11	Q2:11	Q3:11	Q4:11	Q1:12	Q2:12	Q3:12	Q4:12	Q1:13
Real GDP growth, % y-o-y *	8.4	7.5	6.7	6.4	1.0	0.8	-0.2	-0.7	3.5
Agricultural production, y-o-y, % ch.*	8.3	3.9	3.7	4.6	0.6	-2.1	-21.6	-22.4	-1.6
Construction works f-a-p, % ch.*	4.0	12.9	3.1	1.4	4.9	3.6	0.8	-1.3	3.7
Fixed capital investment, y-o-y, % ch.*	132.0	131.8	111.3	109.3	95.4	-0.6	-0.7	-4.1	-2.4
Net FDI flows, y-o-y, % change	25.8	100	-1.8	33.3	-51.3	-26.3	-68.2	-22.2	102.0
Unemployment rate, %	9.4	6.2	5.3	6.2	7.2	4.5	4.8	5.9	8.1
Employment rate, %	34.6	41.9	42.9	38.4	34.3	40.5	41.1	37.9	34.5

*Note: * - cumulative; (e) – estimate;*

Source: NBS, NBM, calculations and estimates EXPERT-GRUP;